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Add	+10% increase in share price	Hold	No change in share price
Hold	+5% to -5% variation in share price	Sell	-10% or more decrease in share price

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**Telecommunications &
Broadband Services****Regulatory Update***Type of Report***INDUSTRY REPORT****Anna Maria Kovacs, Ph.D., CFA****(617) 576-5764****akovacs@yesinvest.com****Kristin L. Burns, Ph.D.****(617) 576-5764****kburns@yesinvest.com****Gregory S. Vitale****(617) 576-5764****gvitale@yesinvest.com****August 22, 2002****THE STATUS OF 271 AND UNE-PLATFORM IN
THE REGIONAL BELLS' TERRITORIES**

- Since our May report, the FCC has granted 271s in four states: Georgia and Louisiana for BellSouth and Maine and New Jersey for Verizon. Applications for seventeen states' 271s are before the FCC now. By year-end we expect all of Verizon to be covered by 271s. We expect Qwest to have 271s in all but one or two states (Minnesota and Arizona being the ones we expect to lag). We expect BellSouth to have all its 271s except Florida. Finally, we expect SBC to add California late in 2002, but do not believe the Ameritech states will get their 271s until the first half of 2003.
- As part of the 271 process, UNE rates since May have been reduced in many states, most notably in the Qwest Region, but also in SBC and BellSouth states. We expect some more UNE reductions (Massachusetts, New Jersey and Pennsylvania are pending for Verizon, for example) but expect the pace to slow given how much UNE rates have decreased and given that the 271 process that drives some of the cuts is nearing its end.
- For the CLECs, the lower UNE rates present the opportunity to enter the local market with minimal up-front investment. It is not clear, however, whether some of the more troubled companies, like WorldCom, will be able to take full advantage. We view UNEP as being positive for the IXC's, particularly AT&T, but do not believe that it is enough to stem the declining revenues and profitability of the consumer long-distance market.
- From the RBOC-investor's perspective, UNEP presents several problems. One is the reduction in revenues that comes from converting retail to wholesale revenues. The other is the pricing compression that comes from the RBOC's own attempts to restructure their prices to compete with the new entrants. Finally, there is the exposure during a period when an RBOC cannot yet enter long-distance, but the IXC's have begun to enter its local market. Among the RBOC's, SBC is by far the most exposed. In California and in the Ameritech states, it has super-low UNEP prices and no ability to counter an IXC's entry with an all-distance plan. It is possible that Verizon will also see some meaningful share loss in the next few months, but we do not see the IXC's being as focused on it as they are on SBC, particularly in California.

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Ratings

Strong Buy

Outperform market near-term and long-term by over 10%

Market Outperform

Outperform market long-term by over 10%

Market Perform

Perform in-line with market (+ or - 5%)

Market Underperform

Underperform market by over 10%



The actual implementation of LNEP accelerated in the last few months, as MCI division introduced its Neighborhood Plan in April and prepared ready to pursue entry in at least the urban zones throughout most of the country. Entry will likely hardest to protect its long-distance market. WorldCom's MCI and Massachusetts this year. We expect it to push hard in California, where it and AT&T has indicated that it will also enter Pennsylvania, California, and New Jersey. It has added Michigan, Georgia, Illinois, Ohio, and Texas. Since March, it has added New York, Georgia, Illinois, Ohio, and Texas. Early 2002, AT&T was offering LNEP-based local service only in New York two since March of 2002 and will probably add another two states this year. In April, AT&T has added local LNEP-based service in six states to its original MCI division, in partnership with ZTE. Tel launched its Neighborhood Plan in competitive carriers (LUC) have focused more on this market. WorldCom's CLEC will likely hardest to protect its long-distance market. WorldCom's MCI will likely hardest to protect its long-distance market. WorldCom's MCI

two than we have seen in the last few months. We expect a slower rate of change to LNE prices over the next year or ending. We expect a sharp in most states over the last year and because the 271 process is lowered sharply in most states over the last year and because LNE rates have been made as part of the 271 process. Thus, both because LNE rates have been New Jersey, Texas and Pennsylvania are doing now—most changes have been of the 271 process—as New York did earlier this year and as Massachusetts, while commissions do occasionally change LNE prices independently prices. While commissions have made changes to their unbundled network element (LNE) commissions have made changes to their unbundled network element (LNE) except Florida, all Qwest states except Minnesota and possibly Arizona, and all Vermont states, SBG has a good chance of having California granted by year-end, and a slight chance of having Michigan granted as well, with the rest of the American states likely to slip into the first half of 2003.

By year-end 2002, we expect 271s to cover all BellSouth states except Florida, all Qwest states except Minnesota and possibly Arizona, and all Vermont states, all Qwest states except Minnesota and possibly Arizona, and all Vermont states, SBG has a good chance of having California granted by year-end, and a slight chance of having Michigan granted as well, with the rest of the American states likely to slip into the first half of 2003.

The flood of applications for in-Region long-distance entry under section 271 of the Telecom Act (271) is reaching its crest. Fourteen 271s have been granted to the Regional Bell Cos (RBOCs) so far, and the FCC has applications for seventeen more before it stops. Alabama, Kentucky, Mississippi, North Carolina and South Carolina for BellSouth; Colorado, Idaho, Iowa, Nebraska, Connecticut, Delaware, and Virginia for Verizon; North Dakota, Montana, Utah, Washington, and Wyoming for Qwest; New Hampshire, Massachusetts, Rhode Island, and Vermont for Bell Atlantic.

Over three months have passed since we last published our report "The Status of Bell's Telecommunications in the Regional Bell Cos." Given the recent flood of 271 and LNE-Pilot from the Regional Bell Cos, we thought it timely to provide an update on the status of 271 filings with the FCC and the communications changes to LNE-Pilot (LNEP) rates made by individual state commissions. We thought it timely to provide

would not be surprised to see switching removed as an element in some current FCC analysis, but the FCC's decision reinforces it. For example, we more granular analysis than it had done in the past. That was the bent of the the conclusion, the various court decisions are likely to drive the FCC toward after the court rules, most likely some time next spring. Aside from delaying belief in its unlikely that the FCC will issue an order in the terminal review till to conclude this year. If the FCC Circuit does accept the FCC's appeal, we still meet the "necessary and impartial" test. The terminal review was expedited which was initiated by the FCC in December of 2001 to decide which LNEs ■

All of these judicial decisions will have an impact on the terminal review D.C. Circuit some aspects of the court's decision. vacated the FCC's line-sharers order. The FCC has appealed back to the full Supreme Court's "necessity and impartial" standard. The D.C. Circuit also FCC attempted to refine the list of required LNEs in accordance with the Circuit of Appeals remanded to the FCC the 1999 LNE order in which the Board v. FCC decision (in May 2001, in its LS1A, FCC decision, the D.C. standard, which it had already highlighted in its January 1999 Low Voltage Version decision, the Supreme Court reaffirmed the "necessary and impartial" The long-term survival of LNEP is, nevertheless, in question. In its May 2002 ■

by the Telecommunications Act for the purpose of setting LNE prices. designed any method other than rate-of-return, which is specifically precluded FCC decision, the Supreme Court appeared to affirm the FCC's right to prices are set. More broadly, in its May 2002 Version Communiactions v. Element Long Run Incremental Cost) as the methodology by which LNE The Supreme Court has affirmed the FCC's right to designate TELRIC (Total ■

year, but neither the timing nor the level of effort in those states is clear to us. AT&T has indicated that it will enter Pennsylvania and Massachusetts this lost much market share since rates in New York were lowered in January. relatively stable vs. May of 2002. It is also worth noting that Verizon has rate at \$20.23 is the second lowest in a Regional basis, but that rate is into Qwest's territory is a high priority for the IXCs at any price. Verizon's has dropped from \$28.21 to \$23.97. However, we do not believe that entr recently dropped in a number of states, so that the Regional average LNEP rate expect BellSouth to have a 27% till late first quarter 2003. Qwest's rates have AT&T has not yet entered Florida. Florida is the only state in which we do not BellSouth is seeing LNEP-based primarily in Georgia and Florida, but As we indicate below, LNEP discounts are greatest overall in the SBC Region is also in Michigan, Illinois, and Ohio, where it is uniquely that SBC will be able to respond on the long-distance side till sometime in the first half of 2003. AT&T just began deploying LNEP in California, where SBC will now be able to respond on the long-distance side till around year-end 2002, at best. AT&T ■

AT&T in the open, the greatest exposure to changes in LNE prices is to SBC in a small number of states on AT&T's. LNEP. We expect some backing off on WorldCom's part, and a harder push out with Comcast it is somewhat difficult to predict how hard they will push ■

markets fairly quickly and in others over some longer transition period. Other elements also might be removed over time in some geographic and customer markets. If the FCC decides to take granularity down to the wire-center level, it may leave actual implementation in the hands of the states, but with fairly tight rules to guide that implementation. In the context of UNEP, what is significant about the removal of an individual element is that it makes it necessary for the CLEC to do some work to reassemble the line when it inserts its own equipment. That will make it more difficult to move large numbers of customers rapidly. Thus, the timing and outcome of the triennial review is very important both to the CLECs IXCs who use UNEP and to the RBOCs who are wholesaling lines to those CLECs IXCs at deep discounts.

- The actual financial impact of UNEP on either the RBOCs or their competitors is, of course, what investors care about. Unfortunately, it is difficult to quantify because it depends so much on the companies' strategies. The more CLECs are able to cream-skim in a given market, the better their own margins and the greater the damage to the RBOC. The CLECs' ability to cream-skim, in turn, depends not only on the CLECs' own strategies, but on the RBOCs' win-back efforts, which often include the introduction of new pricing plans and the RBOCs' ability to offer all-distance plans. Thus, damage to the RBOCs' financials comes not only from the conversion of retail revenues to wholesale revenues, but from a broader repricing in response to competition. The offset from long distance appears to be fairly minor, at this point. Although ultimately all-distance customers may be "suckier" than those who use only one service, initially both sides are likely to spend more on marketing to fight churn than they did before.
- Our May 1, 2002 report included one effort at such an analysis. It found that UNEP creates a discount of about 19% to 42% below retail residential revenue. Using the same retail rates, those discounts would now range from 24% to 50%. Another way to look at the issue is to use the FCC's rate reference book, which relies, in turn, on TNS bill-harvesting data. According to this data, average residential spending per household on local service is \$426 per year and on long-distance \$176 per year. Assuming 1.2 lines per household, that would equate to about \$30 per line in local revenue plus about \$4 per line in access charges for a total revenue per line of about \$33-\$34. That figure falls within the range of \$30-\$34 for retail consumer revenue that we had estimated in May, although both calculations present potential problems. For the TNS data, specifically, it is not clear whether taxes and Universal Service Fund contributions which an RBOC would simply pass through to the government are included in the revenue. With that caveat, we are using \$33.50 as a national average residential rate. That leads to UNEP discounts on a Region-wide basis of 27% in BellSouth, 28% in Qwest, 48% in SBC, and 40% in Verizon. The TNS numbers also indicate that the RBOC would need to gain more than three long-distance customers to make up for the revenues from any local customer it loses (\$474 of local plus access revenue vs. \$128 of long-distance revenue net of access). And—given the different margin structures of the industries—it needs more than that to make up for the lost cash flow. Of course, to the extent that an IXC can capture small business customers whose



retail spending is higher than that of consumers, the damage to the RBOCs is greater. For some time, at least, while the industry restructures itself into an "all distance" market, the UNEP vs. 271 game is likely to be "negative-sum," with both the RBOCs' and IXC's profits hurt by lower revenue and higher marketing costs



APPENDIX

STATE OF THE MARKET – AUGUST 2002

Changes in methodology and corrections of errors.

- We changed our MOL (minutes of use) assumption from 1200 to 1411, to account for toll minutes, based on footnote 252 of the FCC's Pennsylvania order.
- For the columns that calculate full UNEP based on DEM (dial-equipment minutes), there is no change. Thus, for comparison, we are showing full UNEP based on DEM for both May and August in our tables.
- We corrected an error in the formula that calculated amortized non-recurring charges for Verizon's MA, NH, NY, DE, PA. For NV, KS, MO, OK and TX, we now have some non-recurring charges that we did not have in our last iteration. For Maryland, we are no longer using the compliance rates that we used in May. Statewide loop rate averages changed in several BellSouth, Qwest and Verizon states, though the actual rates did not, based on new estimates of the distributions of lines per zone: KY, LA, MS, SC, NM, ME, RI, PA.
- Once we assemble our data, we ask all the relevant state commissions, RBOCs and the two major IXC's to comment on its accuracy. We received specific feedback on the accuracy of our tables from all the RBOCs and many states.

STATE OF THE MARKET – MAY 2002

- UNE prices continue to trend down.
- For all RBOC's the full UNEP average (assuming DEM) dropped by 10% from that which we reported in May.
- On a national basis, full UNEP average (assuming DEM) now stands at \$20.28 vs. the \$22.58 average we reported in May.
- The range is a high of \$24.38 for BellSouth and a low of \$17.50 for SBC, within the range we predicted in our May report.
- SBC experienced a roughly 20% decline (with an even sharper decline in California) and Qwest experienced a roughly 15% decline in full UNEP (DEM) average since our May report.
- The RBOC-wide total switching and transport average dropped 21%, from the \$8.34 we reported in May to \$6.59 in August.
- Several states' full UNEP (DEM) price appear to increase or actually increased from that which we reported in May. In some cases, as noted above, we changed the non-recurring formula. In some cases we changed the distribution



of loops among zones, thus changing the average. In a few cases, rates actually rose. In AL, FL, LA, MS and SC, there is now a cross-connect charge that is part of the non-recurring charges that we amortize. In Oregon, the port rate increased slightly.

— Anna Maria Kovacs, Ph.D., CFA

— Kristin L. Burns, Ph.D.

Gregory S. Vitale

CURRENt MARKET SPOT PRICES IN THIS REPORT

<u>Company Name</u>	<u>Symbol</u>	<u>Price</u>
BellSouth	BLS	\$25.44
SBC	SBC	\$27.89
Qwest	Q	\$2.82
Verizon	VZ	\$31.18
AT&T	T	\$11.79
WorldCom's MCI	WCOEQ	\$0.12
Z-Tel	ZTEL	\$1.44
Comcast	CMCSK	\$22.99
Dow Jones Industrial	DJIA	8,887.87
S&P 500 Stock Index	SPX	941.06

SOURCE: Examples taken from reports and publications issued under the **DATA PROTECTION ACT**.

Source: Company financial reports and regulatory filings including tariffs, interconnection agreements and ARRA reports. **CIAFF estimates** are based on information available as of December 31, 2009.

Source: *Comparative approaches and insights from business and government* (*Ed. 2*, 1998) by James Martin and Alan R. Davis, *Information Systems and Business Administration* (*Ed. 2*, 1998) by C. C. Abbott and others.

Source: Company financial reports and executive filings, as holding truths under oaths, from commissioners and auditors.

Source: Company financial reports and regulatory filings, including tariffs, interconnection agreements and ARAHS reports. *CCAH estimates*

Source: Chapman & Hall's *Handbook of Library Data*; interagency loan agreements and ARRL's *Reference Circulars*.

Source: www.oecd-ilibrary.org/development/development-data-base_10000.htm

STATE	TELEPHONE RATE (per month)	TOTAL LOCAL ORGANIZING, LOCAL INFORMATION SWITCHING, AND SWITCING, TRANSPORT (per month)			DTU (per month)	DTU (per month)	Other switching and transport (per month)	Local switching and transport (per month)	LOCAL DEMAND (per month)	TOTAL DEMAND (per month)
		SWITCHING	SWITCHING, TRANSPORT	SWITCHING, TRANSPORT (per month)						
KEY INDICATORS										
Illinois	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Indiana	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Kentucky	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Louisiana	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Maine	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Michigan	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Minnesota	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Mississippi	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Missouri	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Montana	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Nebraska	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Nevada	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
New Hampshire	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
New Jersey	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
New Mexico	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
New York	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Pennsylvania	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Rhode Island	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
South Dakota	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Tennessee	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Texas	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Utah	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Vermont	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Virginia	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Washington	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
West Virginia	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Wisconsin	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Wyoming	\$0.01	\$0.01	0.5	0.5	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00

Source: Company financial reports and telephone bills on holding traffic interconnection agreements and ARIS reports, CRTC submissions.

Sources: Company financial reports and regulatory filings in filing traffic, other companies' agreements and ARTISTS reports. © All rights reserved.

ESTIMATED ANNUAL SWITCING COSTS

STATE	TOTAL PRIVATE WALL-OF-FACE minutes (per month)	ESTIMATING LOCATION AND SWITCHING			DTF per month)	DTF per month)	Other Switching and transport fees per month)	Other Switching and transport fees per month)	TOTAL DFM (per line per month)
		SWITCHING rate (\$/min.)	SWITCHING TRANSPORT rate (\$/min.)	SWITCHING TRANSPORT rate (\$/min.)					
KEY POINTS									
Alaska	\$10.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$10.00
Arizona	\$11.94	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.94
Arkansas	\$11.47	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.47
California	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Connecticut	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Delaware	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Florida	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Georgia	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Hawaii	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Idaho	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Illinois	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Indiana	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Kansas	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Louisiana	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Maine	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Maryland	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Massachusetts	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Michigan	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Minnesota	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Mississippi	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Missouri	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Montana	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Nevada	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
New Hampshire	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
New Jersey	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
New Mexico	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
New York	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Pennsylvania	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Rhode Island	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
South Carolina	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Tennessee	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Texas	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Utah	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Vermont	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Virginia	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Washington	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
West Virginia	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Wisconsin	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92
Wyoming	\$11.92	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$11.92

Source: Company financial reports and regulators filings including tariffs, interconnection agreements and ARMs reports. CTA estimates.

RESEARCH DIRECTORY



Business Services

William Sutherland, Director of Research	(215) 282-4019
Michael Viola	(215) 282-3874

Retail: Specialty & Electronics

Richard A. Zimmerman	(215) 282-4017
Ryan S. Zeichner	(215) 282-8016

Specialty Chemicals & Materials

Christopher M. Crooks, CFA	(215) 282-4018
Dawn G. Moehn	(215) 282-4014

Telecommunications & Broadband Services

Anna Maria Kovacs, Ph.D., CFA	(617) 576-5764
Kristin L. Burns, Ph.D.	(617) 576-5764
Gregory S. Vitale	(617) 576-5764

Telecommunications Equipment, Connectware & Network Security

William R. Becklean, CFA	(617) 576-5850
Michael Kern	(617) 576-5848
Guojia Zhang	(215) 282-8020

Administration

Elizabeth-Anne DeStefano	(215) 282-3877
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Institutional Sales & Trading

	(866) 519-6400
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SBC Communications, Inc. (SBC)

Meeting with SBC CFO highlights key initiatives; no estimate or ratings change.

Analyst Comment

11:05 AM - August 22, 2002

Market Outperformer

Large-Cap Value

Price: US\$28.11

United States

Stock data	Price performance	1M	3M	12M
52-week range	Absolute	+5%	-19%	-25%
Yield	Rel to S&P 500	-7%	-7%	-17%
Capitalization	Forecasts/valuation	2002E	2003E	
Market cap	EPS*	US\$2.30	US\$2.30	
Latest net debt/(cash)	GSCOPE EPS*	-	-	
Free float	GSCOPE P/E	-	-	
Shares outstanding	* May differ from US GAAP			

SBC considers fixing the UNE-P mess, as a prime corporate objective. Delayed LD entry in key locations, combined with the lowest UNE-P rates in the country, have uniquely exposed SBC to profit-eroding share loss. Despite this, SBC's CFO Randall Stephenson still sees stable cash flows through aggressive cost cutting, combined with the ability to maintain trends in share repurchases and dividend hikes. Consolidation in wireless is another key objective of SBC. Acknowledging the proliferation of conversations among wireless carriers, Stephenson indicated all talks are still preliminary. In the meantime Cingular is raising prices, sacrificing sub growth, and looking to improve profits.

Full details

WHAT TO DO WITH THE STOCK? We continue our cautious view of telecom, although recent stock price declines make us somewhat less cautious. Within the group the Bells and rural telcos should provide the best returns. And, within the Bells, we continue to view Verizon as the best choice right now. As management indicates, share loss to UNE-P is going to be quite damaging to SBC. And we believe it will suffer the greatest consequences of this phenomenon among the three Bells. Thus, the valuation premium that SBC trades at relative to Verizon on P/E, EV/EBITDA, and dividend yield is probably not sustainable over the next six months. We continue to use our current EPS estimates of \$1.37 for this year and next.

UNE-P A BIG PROBLEM WITHOUT LD SBC has been the most vocal critic of UNE-P and is working hard to raise prices and diminish the negative effect. In the absence of pervasive long distance approval, UNE-P has been and will continue to be very damaging to SBC. With LD approval in the Amcutech region not likely until the middle or second half of '03 and California not likely until year-end '02, SBC stands quite exposed at the moment. However, we should not extrapolate the SBC experience uniformly to the other RBOCs. No others face the unique combination of low priced UNE-P, high residential rates (in the Amcutech region), big concentrated industrial states, and no LD capability. Thus, we don't see Verizon in particular, and BellSouth to a lesser degree, having the same degree of exposure. So, yes, if an ILEC loses a customer to UNE-P it's a big hit to the bottom line – but it has to lose the customer for the hit to be taken. And in our view VZ and BLS are likely to be able to offset this materially better than SBC over the next year. It should be noted that SBC has been enjoying these same benefits share retention in its states where it has long distance approval. SBC intends to file cost studies in key jurisdictions, using the regulatory path as one attempt at raising rates. In addition, it continues to try to use bundling as aggressively as possible to offset share loss.

WIRELESS CONSOLIDATION A KEY OBJECTIVE Newspaper reports have

Frank J. Gornvali, CFA
frank.gornvali@gs.com
Portland: 1-207-772-3300

Jason Armstrong, CFA
jason.armstrong@gs.com
Portland: 1-207-772-3391

Goldman Sachs
Global Equity Research

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exaggerated the speed of wireless consolidation and the progress that has been made to date. However, the desirability of getting a deal done is obvious, and the company acknowledged active conversations. Mr. Stephenson noted that of the two options for deals AWF presents less dilution but greater regulatory and integration hurdles. Voicestream presents higher dilution but far easier regulatory approval and integration. Furthermore, similar to press accounts, he indicated a deal for Voicestream may be impractical without taking in DT as an equity participant (i.e. no all-cash deal). And, importantly, SBC is open to that possibility.

WIRELESS PRICE HIKE DESPITE SLOWER SUB GROWTH. The healing effects of wireless mergers are not nearly upon us yet. In the meantime, Cingular is taking steps to "heal thyself." The price hikes are geared to boost profitability even as it sacrifices sub growth. The particular increase in national plan rates announced this week are geared to both reduce off-network roaming costs and slow down the consumption of TDMA network capacity. SBC and BLS are fully expecting their joint venture to experience low to no sub growth as a result of these actions as well as the customer churn that will be stimulated by the WorldCom reseller shift.

CAPEX TO REVENUE SHOULD BE NO HIGHER THAN 15% AND WILL BE LOWER ABSENT GROWTH. There is a broad effort to cut capex in both wireline and wireless operations. In wireline, Stephenson indicated that current thinking is that capex to sales should be no higher than 15%, and that in the current environment it should be no higher than 13%, and yet it is. Thus further capex cuts should occur. In our view, if demand recovery continues to falter it would not be surprising to see capex to sales fall below the 13% rate, as it has in other countries. On the wireless side, capex cuts are also anticipated. In our view, slower capex spending in wireless is further supported by the prospects of industry consolidation.

COST REDUCTIONS KEY TO MAINTAINING EARNINGS AND BOOSTING MARGINS. SBC sees the margin differential between it and VZ and BLS as indicating an opportunity for further cost cutting. Pointing to opportunities in consolidating call centers, raising efficiencies in network operations and generally trimming overhead costs, Stephenson is focused and confident in using these steps to help improve margins in the face of share loss.

CALIFORNIA DSL EXPERIENCE GIVES CONFIDENCE IN LONG TERM POTENTIAL. In California, SBC is enjoying the benefits of scale DSL operations, having achieved about 10% penetration so far. As a result, operations are already EBITDA positive and on the trajectory to reach SBC's targeted hurdle rate.

The steps that got California to scale include: an effective self-installation program, low help desk costs, effective churn control (down towards 2-3%), and effective marketing against the cable operators. SBC believes that mass market deployment of DSL will occur, and that tiered offerings are one step in getting there. This will allow lower monthly prices for lower speeds, but should be able to maintain an average monthly price of approximately \$10. This is a little higher than our long term estimate, but directionally our models look at the market in the same way. Due to the absence of long distance approval in California and the Ameritech states, SBC will continue to try to bundle DSL as a way of offsetting share loss, indicating that churn falls 75% for those customers taking DSL on top of their local service.

BLS: US\$ 25.99, SBC: US\$ 28.11, VZ: US\$ 32.35

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